

A DIVEST & INVEST GUIDE FOR LOCAL GOVERNMENTS

REDUCING CARBON RISK AND INVESTING IN LOCAL
ECONOMIC STRENGTH

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EXECUTIVE SUMMARY

There is a growing toolbox of measures cities can take to combat climate change. One of these tools, divestment from fossil fuels, is ethical, viable, and a moral imperative. Divestment is strengthened when the funds divested are redirected to climate-positive projects.

Divestment and re-investment help reduce the carbon risks of cities. Taking inventory of what funds the city has control over and identifying which ones are invested in fossil fuel industries is the first step and an easy hurdle. There are a couple ways fund managers and cities can re-invest these funds to help balance out their portfolios.

TRADITIONAL MARKET APPROACHES:

Reinvestments of funds in different stocks. Some cities might use this as an opportunity to invest these funds into clean tech, renewable energy projects, or other types of socially responsible investing.

EMERGING APPROACHES: Economically Targeted Investments (ETIs) and other local impact investing strategies. These entail investments with market rates of return but also improve the economic wellbeing of a region by stimulating job and business creation or increasing or improving the stock of affordable housing and building infrastructure. This can be done through Green Revolving funds, Community Development Financial Institutions, and Green Banks or Infrastructure Banks.

OTHER INVESTMENT OPPORTUNITIES:

Approaches such as geographically targeted investments in greenhouse gas reduction venture capital, small business loans, and energy efficiency or renewables for new or existing affordable housing.

SUMMARY

Determine if you have funds that should be divested and work to reduce your carbon risk. Reinvest the capital moved from fossil fuel stocks – consider a Green Bank or Revolving Loan Fund

Identify what opportunities there are to attract “fossil free” investments to sustainable projects in your city via green bonds or other mechanisms

Ensure that any jobs created through this process are quality jobs

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It is up to local governments to lead the nation's fight against climate change. Cities are reducing emissions, making their infrastructure less vulnerable, and working with other cities to amplify their impact.

There are more benefits to a divest/invest strategy than just ethical portfolio rebalancing. Cities have an opportunity to use this tactic as a chance to make themselves attractive to green investment. This can be done via direct investments or Green Bonds. Any entity with bonding authority (e.g. the City) can develop sustainable projects and fund them via a green bond issuance, subject to borrowing caps and other restrictions.

Many projects can be a sound investment that offer a market rate of return while reducing greenhouse gas emissions and potentially creating local jobs. These projects could include building energy efficiency upgrades, renewable energy generation, green water infrastructure, improvement of public housing to green public housing, and transportation improvements. These investments can also help working families within cities through projects that launch initiatives that build good jobs into the fabric of a greener city; it is a green workforce development opportunity.

It's possible that a city might find it difficult to fund initiatives like this by itself. One possible way to overcome this barrier is a multi-city climate investment fund. Multi-city climate investment funds hold a significant potential to rapidly increase the scale of climate-forward investments. These funds use the existing channels and stature of municipal bonds for projects focusing on renewable energy generation, energy efficiency, clean transportation, and other projects that offer value capture across several cities. This can help cities leverage the scale of capital, they can pool more money together and drive down the costs of investment, creating opportunities for large-scale projects.

Ultimately, successful divest/invest strategies are a matter of political will. If your city is ready, here are some of the first steps a city should take:

1. Determine if you have funds that should be divested and work to reduce your carbon risk. Reinvest the capital moved from fossil fuel stocks – consider a Green Bank or Revolving Loan Fund
2. Identify what opportunities there are to attract “fossil free” investments to sustainable projects in your city via green bonds or other mechanisms
3. Ensure that any jobs created through this process are quality jobs

INTRODUCTION

It is up to local governments to lead the nation's fight against climate change. Cities are reducing emissions, making their infrastructure less vulnerable, and working with other cities to amplify their impact. In spite of the many commitments to action by cities, in many instances they lack the resources necessary to do as much and as rapidly as they need. Unlocking new investment in climate solutions for cities would open up tremendous potential to create good jobs for local residents, reduce climate pollution, and help prepare for the impacts of climate change.



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While many cities are focusing on mitigating emissions and protecting their physical infrastructure, they may be neglecting another consequential risk of climate change: the long-term viability and ethics of the investments that support their pensions and other financial obligations. In many cases, these investments include companies that control vast reserves of fossil fuel assets. The stranded asset argument for divestment from fossil fuels is simple: Either we address climate change by drastically reducing the amount of fossil fuels we burn, which in turn negatively affects the value of companies that hold these resources, or the climate changes rapidly, at a minimum significantly destabilizing the global economy along with investments in fossil fuel companies. Investments in fossil fuel companies are a risky proposition, and continuing to hold them potentially opens an organization up to legal problems resulting from breaching their responsibility to fiduciary duty. For a fuller exploration of the financial and political reasons for divestment, please see our guide.¹

Beyond the fiscal implications, many city leaders addressing carbon risk are opposed to investing in a destructive industry; if it's wrong to wreck the climate, then it's wrong to profit from doing so. Divesting from fossil fuels can be a powerful moral statement. Even in instances where cities have few direct investments in fossil fuel companies, divesting is a clear statement of opposition to the ethics of the fossil fuel industry and its impact on our environment. More than 100 cities worldwide, ranging in size from New York City, Berlin and Paris, to Berkeley and Kansas City have committed to divesting.

In addition to reducing the carbon risk of stranded assets, the question of how to reinvest funds opens up possibilities for prudent local government action. We aim here to give an overview of innovative approaches US cities can take for reinvestment while maintaining proper diversification and managing risk.

There are multiple approaches to be taken, from traditional market investments in companies focused on climate solutions to economically targeted investments in energy efficiency projects in a specific community. All have been used by entities reinvesting fossil fuel funds into other sectors. Pensions and municipal governments tend to take a conservative approach to investing, but the threat of climate risk, liability from inaction, and the commonality of investments in the oil industry are increasing the urgency to act. If carefully structured, these reinvestments will reduce emissions, increase resilience, and ensure that any jobs created provide good wages and benefits.

Local governments have a unique ability to lead and inspire others in their community through their actions; divestment carries a powerful ethical statement that can have significant local financial benefit.

Reinvestment also presents the possibility of effectively leveraging divested funds by creating innovative financing structures like green banks or green revolving loan funds. These create a longer-term impact that can trigger additional investment, including opening up access to private sector capital.

This guide will briefly examine the case for addressing climate risk in investments, examine potential solutions and ways to implement them, and explore how reinvestments can create good jobs. This is specifically aimed at local governments, though the strategies and approaches have been proven effective in other sectors. Local governments have a unique ability to lead and inspire others in their community through their actions; divestment carries a powerful ethical statement that can have significant local financial benefit.

REDUCING CARBON RISK IN US CITIES

To reduce climate risk in investments, it is first necessary to inventory where a city has its funds invested. For most cities this may include a city's general fund, retirement fund, pension fund, insurance fund, and utility funds. Where this money is invested will vary- some might be in direct holdings, commingled funds (mutual funds), bonds, and more. Knowing the quantity and type of investment is crucial to understanding what can be achieved with these resources. Determining where the funds are invested requires working with the fund manager. They should be directed to assess and disclose the carbon exposure in the portfolio.

The degree of control a city exerts over its pension fund varies and it may be necessary to work with different stakeholders to put in place the necessary agreements to proceed with a risk evaluation. Divestment is often a process of organizing and fostering relationships with key stakeholders. Retirees and current employees can act as powerful messengers in this effort, as their retirement is at risk. In some cities, the pension is managed by the state, which necessitates working with multiple stakeholders to begin the process. There are efforts underway in many states to do so, and cities are powerful partners in these efforts.

It can be difficult to determine a city's carbon risk. For ease, many institutions use the Carbon Underground 200, a list of the largest publicly traded companies organized by the size of their fossil fuel reserves. This identifies investments that are directly implicated in the extraction of fossil fuels, but it is also possible to expand the scope of divestment. For example, companies that rely on processing fossil fuels, or utilities that are entirely dependent upon them but don't directly possess carbon reserves are also potential targets for divestment. Some jurisdictions have even refused to invest in financial institutions that indirectly support fossil fuel companies.²



Once the investments are identified and carbon risk is assessed, a city can begin to mitigate exposure to these risks. This involves directing the fund managers to sell the at-risk investments. To minimize transaction costs, this can be done over a period of several years as part of the regular rebalancing of the portfolio. Most institutions that divest are committed to a five-year timeline, though many are completing the process far ahead of the fifth year. Institutions that are heavily invested in commingled funds may be more complicated to divest, though there are increasingly fossil-free options, and fund managers are becoming more comfortable with addressing carbon risk. See fossil free funds³ for information on fossil free or low-carbon investment options.

Fund managers occasionally balk at divestment requests, but they should be able to rise to the challenge of ensuring a diversified portfolio even with specific companies excluded. This is a far smaller sector of the market than was targeted under South African apartheid divestment- a process successfully managed by many institutions in the 1990s.

Of course, if a city pursues more aggressive locally targeted investment options, the process may be slower and more complicated.

REINVESTING IN SOLUTIONS

The question then becomes – what can a city do with its freed-up funds?

TRADITIONAL MARKET APPROACHES: On the most basic level, cities can balance portfolios that include fossil fuels by reinvesting in different stocks or other investments, in keeping with the city’s fund management philosophy. Alternatively, cities can apply a positive screen for new investments. For example, a city might invest a certain percentage in clean tech, renewable energy projects, or in specific companies and projects. There are many managers and a great deal of research focused on socially responsible investing that use environmental, social, and governance factors to assess investments within the context of the market.

EMERGING APPROACHES: Cities hold tremendous potential to create climate solutions that offer a market rate of return, with the possibility of creating good jobs for residents.

Cities are not the only institutions looking to reduce their exposure to carbon risk. Over \$7 Trillion in investments from a wide range of institutions and individuals is committed to divestment.

While the green/local/good job nexus is a relatively new opportunity, Economically Targeted Investments (ETI's) and other local impact investing strategies are far from untested. These entail investments with market rates of return, but also improve the economic wellbeing of a region by stimulating job and business creation such as increasing or improving the stock of affordable housing and building infrastructure. By focusing investments in climate solutions locally alongside a workforce development pipeline and strong labor standards for jobs created, local benefits are maximized.

The capital structure of this investment could take many forms, and if carefully structured, could attract significant additional investment, including foundations or private investors. Potential investment vehicles include:

Green Bank or Infrastructure Bank: A public entity or public private partnership to leverage investment in public or private infrastructure that reduces GHG emissions, such as efficiency upgrades or renewable generation. Examples include the Connecticut Green Bank⁴, Rhode Island Infrastructure Bank⁵, or Chicago Infrastructure Trust⁶.

Green Revolving Loan Fund: Pioneered on university campuses, green revolving loan funds finance energy efficiency upgrades, resource-use reduction initiatives, and other sustainability initiatives by institutions. Savings from projects are rolled over to invest in new projects, and so on. The Billion Dollar Green Challenge, a challenge that encourages colleges, universities, and other nonprofits to invest in “self-managed revolving funds that finance energy efficiency improvements,” released a resource guide that says entities that do this have seen a “median return on investment of 28 percent annually.”⁷ These funds can be managed internally or in concert with an external partner.

Other Investment Options: Other approaches that can yield a rate of return commensurate with risk, liquidity, and transactional costs include geographically targeted investments in greenhouse gas reducing venture capital, small business loans, or energy efficiency or renewables for new or existing affordable housing. Investing in CDFIs (Community Development Financial Institutions) that have an environmental focus is an additional way of further leveraging an investment.

ATTRACTING INVESTMENT CAPITAL

Cities are not the only institutions looking to reduce their exposure to carbon risk. Over \$7 Trillion⁸ in investments from a wide range of institutions and individuals is committed to divestment. Inevitably, these funds will need to be reinvested somewhere. Cities should explore ways to attract this capital to support their sustainability priorities. This can be done via direct investments or Green Bonds. Any entity with bonding authority (e.g. the City) can develop sustainable projects and fund them via a green bond issuance, subject to borrowing caps and other restrictions.

Many projects can be a sound investment that offer a market rate of return while reducing greenhouse gas emissions and potentially creating local jobs. While the precise structure of these investments could vary (as outlined previously), the goal is the reduction of waste or avoidance of future cost, with mechanisms to capture the benefit from doing so locally.

Examples include:

Building Energy Efficiency Upgrades: Projects to improve the energy efficiency of buildings, particularly ones controlled by institutions (municipal, school, university, hospital) are well-established investment opportunities with strong (and in some instances guaranteed) returns. They can create good jobs, save money for local institutions, and reduce climate pollution. The residential market also provides significant opportunity for job creation and cost reduction for residents⁹.

Renewable Energy Generation: The renewable market is rapidly maturing, with a host of increasingly tested approaches and firms. Projects can range from large-scale wind, solar, or cogeneration to smaller distributed projects. Of particular interest is the installation of solar in low-income communities.

Green Water Infrastructure: Projects, such as those envisioned by Allegheny County's consent decree with the EPA, use green infrastructure to address storm overflow events¹⁰. Green infrastructure minimizes the use of emission-heavy concrete and increases city resilience in the face of climate catastrophe. Waste and wastewater treatment plant energy generation through biodigestion facilities, a prime example being the East Bay Municipal Utility District¹¹, is also an established cost reduction strategy.

Improvement of public housing/construction of new, green public housing: Reducing the cost of public housing by increasing the energy efficiency of residences, or making new public housing more energy efficient upon construction, represents a possible investment option.

Transportation improvements: Public transit projects, system efficiency upgrades, fleet fuel transitions, or EV infrastructure are all sound low-carbon investment options.



East Bay Municipal Utility District, Oakland, CA

Multi-city climate investment funds hold a significant potential to rapidly increase the scale of climate-forward investments.

The return on investment for all of these projects can vary greatly, but with careful planning and due diligence all are viable investments that offer reasonable rates of return. There are many examples of projects like these to learn from, and while offering specific guidance on each is beyond the scope of this guide, city leaders should not feel that they have to begin from scratch. Other local governments or private investors have successfully implemented these and alternative projects and can serve as useful resources and points of reference.

LEVERAGING ADDITIONAL SCALE AND FUNDS

Multi-city climate investment funds hold a significant potential to rapidly increase the scale of climate-forward investments. These funds use the existing channels and stature of municipal bonds for projects focusing on renewable generation, energy efficiency, clean transportation, and other projects that offer value capture across several cities. The investments are bundled into a City Climate Note, which is essentially a bond index. Risk is minimized by carefully choosing appropriate projects and by sufficient diversification as scale is reached. This climate note is then sold to the market. Cities have access to funds earmarked for climate solutions which helps prioritize these projects among other expenditures.

Institutional investors, in particular public pension funds that are divesting, are likely candidates to invest in climate notes. The high credit rating of many cities and proven payback of many of these projects represents a relatively safe investment option. The climate note represents a diversified and convenient place for institutions to move these funds, while reinvesting in their communities' economies and resilience.

In addition to local government participants, a large financial entity is necessary to manage the financial aspects of bundling and selling the projects. The projects must be assessed; modeling recent assessments of green bonds is especially useful here. Each participating city must bring projects to the table. By working together, projects can be selected that not only meet investment criteria but also have a significant impact on emissions. Examples include large scale renewable generation, deep energy efficiency building retrofits, green stormwater infrastructure, and public transportation. Furthermore, City Climate Notes' total project environmental and economic impacts can be clearly calculated and published, which can deepen the public impact of the work.

As the funding and pipeline for these projects will be managed by a central entity, cities and other partners can develop guidelines or requirements for project implementation.

By combining to issue debt that will fund many large scale climate projects, a climate note created by cities could rapidly increase the scale and scope of this vital investment.

HOW DO WE ENSURE THAT JOBS CREATED ARE GOOD?

Jobs that are focused on reducing carbon intensity are not automatically good jobs, and they do not necessarily benefit displaced workers or those most in need. However, there are some established strategies to make sure these jobs support the community. Strategies include:

WAGE FLOORS help lift wages for workers across sectors and stimulate the economy, while reducing the amount of workers and families that depend on assistance programs. Seattle's successful minimum wage legislation has shown that concerns around raising wage floors are unfounded¹². Raising wage floors can also make less desirable positions more appealing¹³.

FAIR SCHEDULING REQUIREMENTS help a city's most vulnerable populations, who often are victims of unpredictable work schedules, making it difficult to not only meet ends meet but handle life outside of work. It is also a gender equity issues as most of the time it is women who are most impacted by unfair scheduling¹⁴. By mandating fair scheduling, a city can promote economic security for low-wage and hourly workers, and it becomes easier for workers to plan out their monthly income. In conjunction with local hires and higher wage floors, cities can improve the economic security of their hard working families. Seattle¹⁵ is a great example of a city passing a fair scheduling ordinance.

EARNED SICK TIME is both an economic¹⁶ and health¹⁷ imperative for cities. According to the National Partnership for Women & Families, both businesses and workers benefit from paid sick days. They help reduce turnover, increase productivity, and prevent disease and illness spread. Since many jobs that don't have paid sick leave are in the service industry and are frequently in direct contact with customers or clients, it is a public health risk to not have paid sick leave. Workers without paid sick leave may also accrue higher medical costs because of delayed treatment, which amplifies their economic burden.

LOCAL HIRE¹⁸ AND APPRENTICE UTILIZATION REQUIREMENTS help cities make sure investments are benefiting their residents. In conjunction with apprenticeship requirements, cities can increase their skilled workforce and strengthen their local economy.

HEALTHCARE ACCESS is important in the creation of good and secure jobs. With many workers without healthcare being forced to choose between rent, other bills and treatment, a lack of healthcare can also create economic instability.

RETIREMENT BENEFITS help create long-term economic security for workers and families. Seniors and other aging workers across the nation are facing a retirement crisis that is putting a significant economic strain on family units. Strong retirement benefits reduce this strain and secures the long-term economic stability for families.

PAID PARENTAL AND FAMILY LEAVE (PPFL) can have a large and positive impact on workers and families. The United States is far behind other developed nations when it comes to PPFL. Local and regional governments can play a significant role in advancing PPFL legislation. PPFL has a positive impact on workforce development, worker retention, childhood development, and gender wage gaps¹⁹.

All can be passed by ordinance (and thus applied to all jobs) or incorporated into contracts to ensure job quality. If for a reason such as state preemption your city cannot pass these as ordinances, then applying them to city contracts and citywide employment practices is the next step to take.

A workforce development effort is needed to prepare residents with the skills required and to connect them to jobs as they become available. This would be a great opportunity to develop a Green Jobs Initiative²⁰. This can be done by building on existing foundations of local workforce development systems. Cities can focus on embedding green skills training within current curricula for green infrastructure projects- such as retrofitting buildings do not require “green construction workers,” but rather workers with traditional construction skills who are also trained on energy-efficient construction.

These types of investments, even outside of Green Jobs, are important in improving job quality for working families. By establishing workforce development policies, cities can help local boards connect workers to the best possible jobs, and supporting employers with efforts to improve jobs²¹.

CONCLUSION

Local leaders are careful stewards of their communities’ resources, and plan with caution to avoid future catastrophe.

Climate change poses a tremendous risk to communities and the investments that their retirees and others will rely on in the future. The risk posed to these investments by the carbon bubble is significant, but fortunately there is a significant and growing array of reinvestment opportunities, from traditional market funds to targeted community investments. Some of these require more diligence and financial sophistication than others. In all cases, it is possible to construct an investment structure that mitigates financial and carbon risk while investing in projects that offer market returns and fight climate change.

Successful divest/invest strategies are a matter of political will. As the saying goes, political will is a renewable resource in and of itself.

First steps a city should take:

1. Determine if you have funds that should be divested and work to reduce your carbon risk. Reinvest the capital moved from fossil fuel stocks – consider a Green Bank or Revolving Loan Fund
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3. Ensure that any jobs created through this process are quality jobs

RESOURCES

- [Divestment from Fossil Fuels: A Guide for City Officials and Activists](#) (Mayors Innovation Project 2014). A guide for cities and activists on how municipalities can divest from fossil fuels.
- [Climate-Related Investment for Resilient Communities: Divest-Invest Opportunities in Community-Oriented Climate Solutions](#) (Croatan Institute 2016). How cities can launch community-oriented climate solutions as they divest from fossils and then invest in sound investment projects.
- [2 Degrees of Separation: Transition risk for oil & gas in a low carbon world](#) (Carbon Tracker & Principles for Responsible Investment 2018). An analysis and guide around the largest oil and gas companies, and the risks of investment as the world de-carbonizes.
- [Trillion Dollar Transformation: Fiduciary Duty, Divestment, and Fossil Fuels in an Era of Climate Risk](#) (Center for International Environmental Law 2016).
- [Green America](#), a resource on climate responsible portfolio investment
- [New York City Comptroller Pension/Investment Management](#). New York Cities Comptroller page on pension and investment management, a useful tool for any city looking to join NYC in divesting from fossil fuels.

ENDNOTES

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19. United States Congress Joint Economic Committee Fact Sheet on the Economic Benefits of Paid Leave, https://www.jec.senate.gov/public/_cache/files/646d2340-dcd4-4614-ada9-be5b1c3f445c/jec-fact-sheet---economic-benefits-of-paid-leave.pdf
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About us

The Mayors Innovation Project is a learning network among American mayors committed to “high road” policy and governance: shared prosperity, environmental sustainability, and efficient democratic government. We are a project of COWS. This work is generously supported by the Wallace Global Fund. We can be contacted at:

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